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IN THE
SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, A. D. 1944

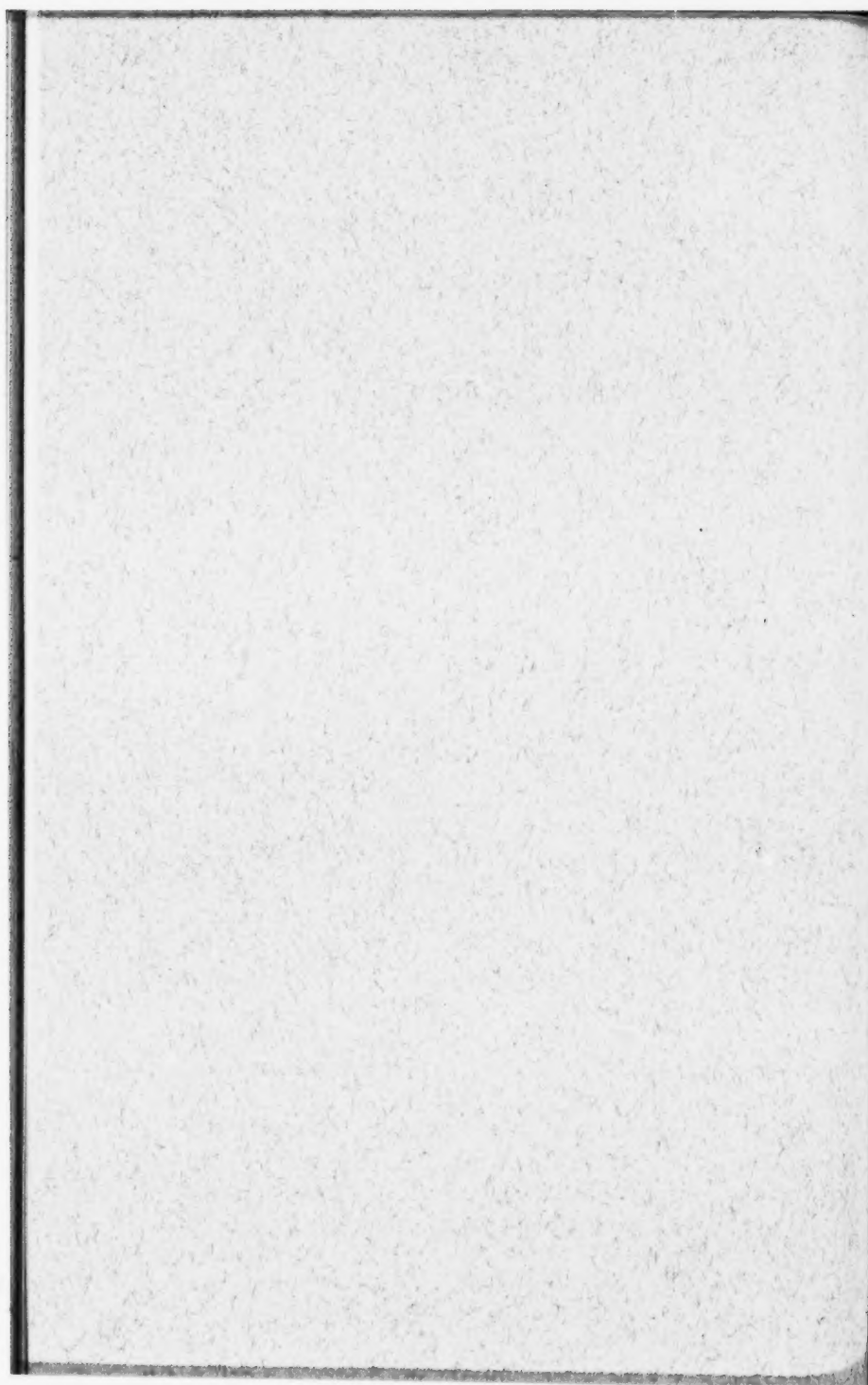
EDWARD MALLINCKRODT, JR.,
Petitioner,

vs.

**JOSEPH D. NUNAN, JR., COMMISSIONER OF INTERNAL
REVENUE**

**REPLY BY PETITIONER TO BRIEF IN OPPOSITION
FILED BY RESPONDENT**

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Undistributed Income Remained Property of Trust Estate

The unexercised *power* of petitioner to demand of the trustees the payment of income from the trust did not, *ipso facto*, make such income *his*. Until the condition precedent of a demand had been complied with, the income remained the property of the trust, was not segregated or separated therefrom, and passed into the principal of the trust with the end of the current year, for further administration.

Under the statutory scheme for taxation of trusts, the undistributed trust income was taxable to the trust estate with no deduction allowable under Section 162(b) because, as the Circuit Court of Appeals correctly held, the undis-

tributed trust income was *not* "to be distributed currently" by the fiduciaries to petitioner (R. 362), and, hence was taxable to the trust under Section 161 (a) (1).

The trustees reported the undistributed income as trust income and paid the taxes thereon for each of the years 1934-1937, inclusive. The trustees and petitioner relied upon the unambiguous language of Sections 161 and 162, and upon the authority of *Appeal of Elizabeth S. Sprague*, S B. T. A. 173, which case was decided in 1927 and has never been expressly overruled. The unfairness of now taxing such undistributed trust income to petitioner under Section 22(a) by a "strained application" (R. 119) of the Supreme Court decision in *Helvering v. Clifford*, 309 U. S. 331 (decided in 1940), is patent and shocking to any concept of fair treatment between a Government and its citizens. Simple justice requires that Sections 161 and 162 should not be emasculated by judicial legislation through the guise of a strained construction of Section 22(a).

Respondent Erroneously Evaluates Control of Petitioner Over Trust Corpus

Seeking an escape from the specific statutory provisions governing taxation of the income of trusts, the respondent contends, in effect, that they ought not to apply here because the two trustees (subject to the approval of both) have power, upon the written request of petitioner, from time to time to distribute such portions of the corpus as they deem wise and for the benefit of petitioner or of his family. That provision, *in itself*, did not make petitioner the owner, in whole or in part, of the corpus of the trust estate. The presence of such an unexercised provision, *ipso facto*, did not destroy, and render impossible the continuance of, the trust.

Since the trust (in spite of such an unexercised provision) still persists, the plain provisions of Sections 161 and 162

(of the Revenue Acts of 1934 and 1936) must be applicable to the income of that trust.

Quite the same considerations apply to the power conferred upon both trustees under particular circumstances to terminate the trust.

The respondent further contends that petitioner was one of the two trustees named in the Trust Indenture; that he was empowered upon resignation to appoint his successor; and, therefore, that the corpus of the trust estate must be regarded as his, and under his sole dominion and control.

The respondent here overlooks the fact that any distribution from the corpus of the trust estate during petitioner's lifetime requires that both trustees concur in the finding that such distribution is wise under the circumstances and for the benefit of petitioner or of his family. The approval of the Trust Company, as co-trustee, is essential; and the only evidence upon that subject shows the Trust Company to have been independent and intractable. The corpus of the trust estate was plainly not petitioner's property nor under his sole control and dominion; and the *trust* subsisted. Why evade the plain statutes applicable to trust income?

The claim of control and domination over the trust corpus now advanced by respondent perpetuates the error in the notice of deficiency served upon petitioner in 1940. There, respondent erroneously predicated his claim, in part, upon the fallacious contention that petitioner "had full control and complete domination over the corpus of the trust" (R. 57, 59, 62 and 65).

Ignoring the specific provisions of the statutes respecting the taxation of the income of trusts—and still pursuing the *ignis fatuus* of "*economic equivalence*"—the respondent says that petitioner had a general power of appointment by will over the corpus of the trust property, and, therefore, that the income of the trust must be regarded as the income of petitioner. Such a power is certainly not a present

ownership of the corpus of the trust estate. Until exercised by an effective will, such a power leaves absolutely unaffected and unimpaired all other interests in both corpus and income of the trust property. The mere existence of such a power cannot, therefore, detract from the continuous existence of the trust, nor subtract from the trust estate the income or principal forming part thereof.

Prior to the Revenue Act of 1942, an *unexercised* general testamentary power of appointment held by a beneficiary under a trust did not cause the trust property to be included in his gross estate for purposes of taxation. *Helvering v. Safe Deposit & Trust Company of Baltimore*, 316 U. S. 56. It is now true that regardless of whether petitioner exercises the general power of appointment by will given him under the trust, a specific statute (Section 811(f) of the Internal Revenue Code, as amended by Section 403(a) of the Revenue Act of 1942, c. 619, 56 Stat. 798) will cause any trust corpus in existence at the time of his decease to be included in his gross estate for taxation purposes. Of course, this will not happen if petitioner has relinquished the power of appointment within the time authorized by the Revenue Act of 1942. However, in no event will the undistributed trust income or the trust corpus escape the taxation prescribed by applicable statutes. Moreover, the undistributed trust income in this case which accrued during the period 1934-1937 cannot be taxed to petitioner under Section 22(a) without doing violence to Sections 161 and 162.

"Implications" Deducible From Clifford Case Furnish Mythical Standards for Guidance of Lower Courts and the Public

The case of *Helvering v. Clifford*, 309 U. S. 331, is considered to have established the general principle that the Government is not required to tax trusts as separate en-

tities where the terms of the trust indenture, the manner of its creation, and the method of its operation indicate that it is not to be distinguished from the *grantor* for tax purposes. In the instant case the petitioner is the beneficiary of a *bonda fide* trust instead of the grantor of a colorable trust.

There was no unanimity of opinion amongst the judges of the Tax Court in applying the doctrine of the *Clifford* case to the facts of the instant case. The majority opinion in the Tax Court held petitioner taxable on the undistributed income of the trust under Section 22(a) and in so doing relied upon an extension of the doctrine of the *Clifford* case and the case of *Corliss v. Bowers*, 281 U. S. 376. One judge concurred in the result reached "notwithstanding the substantial doubt which I have that the rule of *Helvering v. Clifford*, 309 U. S. 331, should be so extended." (R. 112) Two other judges concurred but did "not think it necessary to resort to the principle enunciated in the *Clifford* case in order to reach the conclusion embodied in the first point." (R. 113); they thought that the undistributed trust income was taxable to petitioner as income "to be distributed currently" by the fiduciaries to petitioner, as beneficiary, within the meaning of Section 162(b). One judge dissented without writing an opinion. Four other judges filed a vigorous dissent on the theory that the doctrine of the *Clifford* and *Corliss* cases was not applicable to the facts of the pending case, and that the undistributed trust income was taxable to the trust estate under Section 161 and 162. (R. 114-119).

The Circuit Court of Appeals agreed with the minority opinion of the Tax Court that the undistributed income of the trust in suit was *not* income "to be distributed currently" by the fiduciaries to petitioner as beneficiary within the meaning of Section 162(b) (R. 362), and had "no quarrel with the views expressed by the minority of the Tax Court relative to the applicability of § 161(a) (1)" (R. 362), to-wit,

that the balance of the net income not so requested by petitioner was "income accumulated or held for future distribution under the terms of the will or trust" within the meaning of Section 161(a)(1) and was, therefore, taxable to the trust under the specific provisions of the statutes. Nevertheless, the Circuit Court of Appeals affirmed the majority opinion of the Tax Court upon the basis of unjustified "implications" drawn from the prior opinions of this Court in the *Corliss* and *Clifford* cases.

The holdings of the majority opinion in the Tax Court and of the Circuit Court of Appeals in this case are in direct conflict with the prior holding of the Board of Tax Appeals in *Appeal of Elizabeth S. Sprague*, 8 B. T. A. 173. The minority opinion of the Tax Court held that the *Sprague* case was not in conflict with the *Clifford* and *Corliss* cases and that the *Sprague* case supported petitioner in the instant case (R. 116).

From the above it is obvious that there is manifest uncertainty among the judges of the lower courts in applying, or extending, the doctrine of the *Clifford* case. Furthermore, it seems clearly apparent that the Tax Court "in the search for a realistic construction of tax legislation" (R. 114) and the Circuit Court of Appeals have exceeded their authority in ignoring the specific statutory scheme for the taxation of trust income, provided in Sections 161 and 162, and have extended the doctrine of the *Clifford* case far beyond any scope intended by this Court. In *Webre Steib Company, Ltd. v. Commissioner*, decided February 12, 1945 and not yet officially reported, this Court considered questions involving the application of the "prima facie evidence" and "presumption" sections of Title VII, Revenue Act of 1936. The Court there recognized its "duty to apply as best we [the Court] may a statute Congress has seen fit to enact." The same duty applies with respect to an unambiguous statutory plan enacted for the taxation of

trust income. Such a legislative plan should not be emasculated by the lower courts upon the nebulous basis of "implications" deducible from prior decisions of this Court.

Conclusion

Unless this Court grants the petition for certiorari and intervenes to define and delimit the proper scope of the doctrine of the *Clifford* case, the erroneous "implications" drawn from that case by the lower courts will continue to defeat the legislative intent of the Congress as expressed in a specific statutory scheme for the taxation of trust income. Moreover, in the administration and creation of trusts, petitioner and the public are entitled to an authoritative decision that undistributed trust income from a *bona fide* trust is taxable to the trust as provided under unambiguous statutes, and that the existing statutory scheme for taxation of trust income has not been, and may not be, supplanted by such unwarranted "implications" as the various lower courts may choose to deduce from the prior decisions of this Court. It is respectfully submitted that the petition for writ of certiorari should be granted.

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